

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PERAR DISCOUNT CENTER, LTD.	:	DETERMINATION
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period December 1, 1979	:	
through November 30, 1982.	:	

Petitioner, Perar Discount Center, Ltd., 2 West Montauk Highway, Lindenhurst, New York 11757, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through November 30, 1982 (File No. 801113).

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 7, 1990 at 9:45 A.M. Petitioner appeared by Jack M. Portney, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Irwin A. Levy, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined petitioner's additional sales and use taxes due on its gasoline service station operations by the use of a third-party methodology.

II. Whether the Division of Taxation properly determined that petitioner is liable for fraud penalties.

FINDINGS OF FACT

On February 24, 1984, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner, Perar Discount Center, Ltd., for the period December 1, 1979 through November 30, 1982 containing the following explanation:

"The following taxes have been determined to be due in accordance with Section

1138 of the Tax Law and is based on an audit of your records. The tax assessed herein has been estimated and/or determined to be due in accordance with the provisions of Section 1138 of the Tax Law and may be challenged through the hearing process by the filing of a petition within 90 days."

The notice asserted additional tax due of \$278,396.35, plus penalty and interest totalling \$162,211.33, for a total amount due of \$440,607.68. The taxes due for the various periods were broken down as follows:

<u>"Period Ended</u>	<u>Tax Due</u>	<u>Penalty Due</u>	<u>Interest Due</u>
2/28/80 - 380	\$13,644.47	\$3,411.11	\$ 7,080.66
5/31/80 - 480	16,945.04	4,236.26	8,250.20
8/31/80 - 181	16,537.54	4,134.38	7,640.50
11/30/80 - 281	15,847.44	3,961.86	6,819.15
2/28/81 - 381	27,791.05	6,947.76	11,086.96
5/31/81 - 481	33,679.03	8,419.75	12,356.16
8/31/81 - 182	33,538.47	8,384.61	11,153.50
11/30/81 - 282	33,933.12	8,483.28	10,029.61
2/28/82 - 382	28,426.53	7,106.63	7,369.86
5/31/82 - 482	27,941.07	6,985.26	6,236.44
8/31/82 - 183	27,941.07	6,147.03	5,228.89
11/30/82 - 283	2,172.52	412.58	328.89"

A consent extending the period of limitation for assessment of sales and use taxes was executed by Kanat Arbay, president of Perar Discount Center, Ltd., dated February 28, 1983 indicating that sales tax due from Perar Discount Center, Ltd. for the period June 1, 1980 through May 31, 1982 could be determined at any time on or before April 20, 1984.

Petitioner, Perar Discount Center, Ltd., operated a Gulf gasoline station at 2 West Montauk Highway in Lindenhurst, New York from about June 23, 1980 to March 1, 1982. The station had six gas pumps and it was determined that two bay areas existed for repair work. Kanat Arbay was president and owner of Perar Discount Center, Ltd.

Initially this case was assigned to Andrew Coughlin of the Special Investigations Bureau late in 1982. Mr. Coughlin visited the office of Jack Portney, C.P.A., on or about October 24, 1982 for the purpose of discussing and reviewing the books and records of various service stations owned by Mr. Arbay. At the same time Mr. Coughlin was investigating Perar Discount Center, Ltd., he was also responsible for the review of the books and records of various other stations owned by Mr. Arbay.

Mr. Coughlin visited the subject premises on or about November 1, 1982 at which time the station was being operated by another party. While at the station he viewed an ST-105 certificate of authority in the name of Cemal Discount bearing an identification number different from the prior owner, Kanat Arbay.

With respect to the request for books and records, Mr. Coughlin testified that he did not believe that he specified which books and records for Mr. Portney to retrieve from the business. The testimony indicates that his recollection was a request for cash receipts and disbursements. However, it was established that Mr. Coughlin was working closely with Mr. Portney with respect to the books and records of various stations owned by Mr. Arbay at this time, and a broad request may have covered more than one station.

At the end of October 1982, Mr. Coughlin sent to Albany for the sales tax returns filed by Perar Discount Center, Ltd. Tax returns were filed by Mr. Arbay, as president of Perar Discount Center, Ltd., for the consecutive periods beginning June 1, 1980 through and including the period ended August 31, 1982. The period covered by the sales tax return encompassing March 1, 1982 through May 31, 1982 indicates no taxable sales made during this period and further, for the subsequent period of June 1, 1982 through August 31, 1982, the sales tax return reflects the company as "inactive".

Mr. Coughlin also testified that at one time an investigation was considered with respect to Cemal Discount, the successor to Perar, and he indicated that some of the tax returns filed by Cemal Discount were also obtained from Albany. The submission of sales tax returns into evidence included a few of the tax returns initially filed by Cemal Discount covering the period September 1, 1981 through August 31, 1982. The first two returns filed by Cemal Discount covering the period September 1, 1981 through February 28, 1982 indicate that it was an inactive company. The first payment of sales tax indicated taxable sales and services beginning with the quarter March 1, 1982, the date which petitioner asserts it ceased operation.

On or about January 10, 1983, Mr. Coughlin issued a subpoena to Gulf Oil Corporation requesting verification of purchases made by Mr. Arbay for the gasoline service station in

question. The Special Investigations Bureau was terminated at this point, still having received no records from Mr. Portney or Gulf Oil. Mr. Coughlin testified that he never reviewed the third-party verification that ultimately became part of the file. Shortly before the Special Investigations Bureau ceased operations, Mr. Coughlin also issued a subpoena to the Long Island Trust Company requesting bank statements that corresponded to deposits made by Mr. Arbay with respect to Perar Discount Center, Ltd. During mid-February he was able to summarize the deposits and the disbursements as indicated by those statements. He testified that the signature card had one signatory power, that of Kanat Arbay. His analysis of the bank deposits indicated that monthly deposits ranged from \$55,000.00 to \$165,000.00, with an average of approximately \$80,000.00 a month. The sales tax returns filed during those periods indicated that Mr. Arbay was reporting approximately 10% or less of the amount of the bank deposits.

The bank statements were being sent to Mr. Allan Stuart, Mr. Arbay's prior accountant. Mr. Coughlin testified that he did not contact Mr. Stuart for books and records and that, although he was working with Mr. Gulotta, another representative of the company, he believed that he did not request books and records from him either.

The testimony indicates clearly that Mr. Coughlin obtained information from various sources but did not retain the file long enough to review any books and records or receive any explanation of the differences between the sales tax returns and the deposits, since the Special Investigations Bureau was terminated while he was in the middle of obtaining information to complete his review.

The next action taken on this case was during mid-January 1984. Once the Special Investigations Bureau had ceased its operations, the files being handled by Mr. Coughlin were transferred to various local district offices. Petitioner's case herein was transferred to the Mineola District Office at which point an assessment had not been issued nor had the investigation been completed. The file was assigned for one day to Allan Korenstein who was asked to expedite it with the information that was available at that time. Mr. Korenstein

testified that he worked with the sales tax returns, the third-party verification from Gulf and other documents contained in the field audit folder. Mr. Korenstein did not contact petitioner nor any of petitioner's representatives hereinbefore mentioned for an explanation as to any of the records contained in the file or with respect to differences found between the sales tax returns and the deposits or the sales tax returns and the Gulf statements.

Mr. Korenstein prepared a field audit report on January 18, 1984 which indicated that the bank statements from Long Island Trust Company for the period July 1, 1980 through February 28, 1982 showed deposits of \$1,978,178.00. It further indicated that sales tax returns filed for the period December 1, 1979 to November 30, 1982 indicated taxable sales reported of \$137,414.00, while the third-party verification of gasoline purchases from Gulf for the same period (December 1, 1979 through November 30, 1982) indicated taxable gasoline purchases of \$3,273,932.00.

Although the field audit report indicates that there was an "audit performed", in fact, Mr. Korenstein computed the additional sales tax due with the information contained in his file and not by any review of books and records or contact with the taxpayer. His computation utilized gasoline purchases per the third-party verification with a markup of 12% to arrive at audited taxable gasoline sales of \$3,695,765.00, resulting in sales tax due on those purchases of \$262,636.41. It is noted in the report that the 12% markup was based on external indices including similar audits performed, average statewide markup for the period and prices being charged at the station.

It is not clear from the record whether Mr. Korenstein or any other party determined that Mr. Arbay did not report taxable repair sales. However, as part of the computation of additional tax due, the field audit report indicates that sales tax due of \$25,534.08 on repair sales was computed by estimating that the 2 repair bays operated during an 8-hour day for 6 days a week for 144 weeks at an estimated \$26.00 per hour labor charge resulting in repair sales of \$359,424.00. Thus, the additional tax due as indicated by the notice of determination issued on February 24, 1984 was \$278,396.35, plus penalty and interest.

Jack Portney, a certified public accountant, appeared on behalf of petitioner to represent his position. Mr. Portney disclosed that Mr. Arbay was a United Nations official and, as a result, had the ability to acquire large allocations of gasoline. Mr. Portney indicated that Mr. Arbay obtained gasoline not only for his own retail sale purposes but also for resale. Mr. Portney indicated that he had invoices, resale certificates and other documentation which purportedly exonerated petitioner, but apparently had not been reviewed by either Mr. Coughlin or Mr. Korenstein during the steps taken by each of them before the notice of determination was issued. At the hearing, Mr. Portney presented such evidence on behalf of petitioner's resale contention as follows:

- (a) sales invoices covering the period January 1980 through September 1981 showing sales of various types of gasoline to Sevinc and Ahmet Batur at 2 Saratoga Boulevard, Island Park, New York and Apokan Discount, 189 Sunrise Highway, Amityville, New York (which is owned and operated by Abdullah Nevruzhan) totalling \$2,464,149.00;

- (b) two resale certificates showing Sevinc Batur and Apokan Discount as purchasers of tangible personal property for resale from Perar Discount Center, Ltd. principally engaged in the business of a gasoline service station dated February 27, 1980 and May 8, 1980, respectively;

- (c) as an analysis of the sales information from petitioner's records, Mr. Portney presented a schedule of purchases of gasoline from June 1980 through February 1982 offset by sales for resale in gallons and dollars, as well as retail sales to customers;

- (d) a statement in Turkish which Mr. Portney claims is notarized as well as an English translation of the same by Abdullah Nevruzhan which states as follows:

"I owned several gas stations from 1978 through 1983 and purchased the majority of my gasoline purchases from the gas stations on Long Island owned by Mr. Kanat Arbay, during the above periods. My gasoline trucks and drivers would pick up the gasoline at night after the stations had closed by pumping directly from the ground tanks into the truck with portable pumps.

I hope this will clarify [sic] the circumstances regarding my relations with Mr. Kanat Arbay and his gas stations.

Respectfully submitted,

Abdullah Nevruzhan"

It is noted that the statement in the English translation is not dated; however, it does appear that the Turkish copy bears a date stamp and date within the body of the notarization of "19/6/1984"; and

(e) a letter of verification from the Henrich Petroleum Equipment Company, Inc. dated July 10, 1985 stating that Kanat Arbay purchased a Blackmer explosion-proof pump from this corporation during the year 1978 and that since the business was unable to locate the invoice, this letter was being submitted as part of the proof of purchase.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner does not dispute the gasoline purchases verified by Gulf but submits evidence and contends that a substantial portion of the gasoline so purchased was for resale and that the Division of Taxation's rejection of such evidence is without foundation. Petitioner asserts that the Division of Taxation has the responsibility to perform an audit, to review the books and records and make a decision on the basis of the books and records before utilizing outside source information. Petitioner's representative severely criticizes the fact that the records were requested and, once assembled, there was no one to whom they could be presented, and further that the case was closed out by an auditor who was instructed merely to make a computation based on estimates without reviewing any records and without contacting the taxpayer or its representative.

The Division of Taxation relies on the supplier verification and the computation on that information in its assertion of additional taxable sales. The Division raises the issue that petitioner did not produce witnesses who purportedly were the purchasers of the gasoline resold by Mr. Arbay. The Division characterizes the actions of Mr. Arbay with respect to his ability to obtain large apportionments of gasoline and his choice to deliver to another party as opposed to

selling it himself as senseless.

CONCLUSIONS OF LAW

A. The Tax Law imposes a sales tax on the receipts from the retail sale of tangible personal property (Tax Law § 1105[a]). A "retail sale" is generally defined as a sale of tangible personal property for any purpose other than for resale or for use in a taxable service where the property sold becomes a physical component part of the property serviced or is actually transferred to the purchaser of the service (see, Tax Law § 1101[b][4][i]). A vendor is obligated to maintain records of his sales for audit purposes (Tax Law § 1135) and the Division, when conducting an audit, must determine the amount of tax due "from such information as may be available" but "[i]f necessary, the tax may be estimated on the basis of external indices" (Tax Law § 1138[a][1]). When conducting an audit, the Division of Taxation may not simply ignore a taxpayer's records if those records provide an adequate basis on which to determine the amount of tax due (Matter of Chartair, Inc. v. State Tax Commission, 65 AD2d 44).

To determine the adequacy of the taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of King Crab Restaurant v. Chu, 134 AD2d 51). The purpose of this examination is to determine if the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commission, supra). Considerable latitude is given to the auditor when the taxpayer's records are inadequate. It is only necessary that the Division select an audit method reasonably calculated to reflect the tax due and then it is incumbent upon the taxpayer to establish that the result of the method used is unreasonably inaccurate or that the amount of tax assessed is erroneous (Matter of Meskouris Brothers v. Chu, 139 AD2d 813). In this case, it is unclear whether an adequate request for books was made in the first instance. Apparently, the Special Investigations Bureau was instructed to review and investigate the operations of a multitude of gasoline stations during a brief period of time. Before such investigations were complete in their entirety, files were closed and transferred to a different division with an

apparent lack of communication between the two offices. Even though it is unclear what records were requested and/or produced, it certainly appears clear from the testimony that the records were not thoroughly examined to determine their adequacy. As a result, the Division of Taxation could not possibly deem the records so insufficient as to render them unable to verify taxable sales and conduct a complete audit. The Division of Taxation failed to determine that petitioner's books and records were inadequate, failed to conduct an audit, and it certainly failed in proving that the assessment was based on an audit of petitioner's records.

B. If it had been impossible to determine petitioner's tax liability solely from the corporate records, a fact which is not revealed in the record herein, resort to outside indices such as purchases from Gulf was proper (Matter of Urban Liquors, Inc. v. State Tax Commission, 90 AD2d 576; Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988). It was then the auditor's duty to select a method of audit reasonably calculated to reflect the taxes due (Matter of W. T. Grant Company v. Joseph, 2 NY2d 196, cert denied 355 US 869). In view of the enormous discrepancy between the corporation's reported sales and its bank deposits for the same period and the equally significant discrepancy between its reported sales and purchases per supplier information, the Division was warranted in questioning the adequacy of petitioner's records and giving serious consideration to an estimate based on third-party verification. Even if one argues that the most accurate way to verify taxable sales in this case was by third-party verification, the Division of Taxation simply ignored the resale step of the transaction. The burden was then placed upon petitioner to show by clear and convincing evidence that the audit methodology was unreasonable or that the results obtained were erroneous (Surface Line Operators Fraternal Organization v. Tully, 85 AD2d 858).

C. Petitioner alleges he was able to obtain enormous allocations of gasoline and did so for the purpose of resale to other gas station owners. Although petitioner did not produce the witnesses who could speak on their own behalf as purchasers of such gasoline, petitioner was able to produce sales invoices for a substantial portion of the audit period in question. These

invoices are supported by resale certificates completed by the parties to whom these sales were made. One of the parties even gave a statement explaining his relationship to Kanat Arbay and his gasoline purchases. Petitioner further supported its case with information regarding the pump that was purchased for the purpose of pumping gasoline from the delivery site to another tank or truck.

D. Clearly, petitioner has met its burden of proving that the results of the investigation and that portion of the "audit" so performed resulted in an erroneous assessment. It is clear in this case that the Division of Taxation performed no review of the books and records and certainly something far less than an audit. The Division also deliberately overlooked records supporting the resale of gasoline by petitioner. In addition, it appears as though there are periods assessed during which time Kanat Arbay did not own and operate Perar Discount Center, Ltd. at the Lindenhurst address.

E. The petition of Perar Discount Center, Ltd. is granted and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated February 24, 1984 is hereby cancelled.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE